

STATE OF MICHIGAN
DEPARTMENT OF LICENSING & REGULATORY AFFAIRS
OFFICE OF FINANCIAL AND INSURANCE REGULATION
Before the Commissioner of Insurance

In the matter of Blue Cross and Blue Shield
of Michigan's application for approval of a
formula for the calculation of large group
rating system /

Order No. 13-007-BC

Issued and entered
this 11 day of February 2013
by Rhonda Fossitt

Special Deputy Commissioner of Insurance

**ORDER APPROVING A FORMULA FOR THE CALCULATION OF RATES FOR COVERAGE
PURCHASED BY LARGE GROUPS**

BACKGROUND

MCLA 550.1608(2) requires BCBSM to refile for approval, every 3 years, the methodology and definitions of each rating system, formula, component, and factor used to calculate rates for group subscribers. On October 3, 2012, Blue Cross and Blue Shield of Michigan (BCBSM) filed with the Commissioner of Insurance (Commissioner) the formula, factors, and definitions for coverages offered to its large groups, as required by MCLA 550.1608(2) and MCLA 550.1610(1). It is noted this market segment was previously called the Experience Rating System (ERS), however BCBSM has elected to rename it the Large Group Rating System with this filing.

On November 2, 2012, the Office of Financial and Insurance Regulation (OFIR) Staff (Staff) determined that the filing was in substantial and material compliance with the requirements of MCLA 550.1610(6) and (8). BCBSM was notified by letter dated November 2, 2012 that the filing had been determined to be complete and was instructed to publish notices of its filing for approval of a formula and factors in newspapers having general circulation throughout the state, to comply with the requirements of MCLA 550.1612(1). On December 7, 2012, BCBSM placed advertisements in newspapers notifying subscribers of its filing and of their right to intervene in the process. On December 11, 2012, the Commissioner sent by certified mail a Notice to Interested Parties as required by MCLA 550.1612. Therefore, the final Order on this filing must be issued within 60 days of the latest of these three notices.

On February 9, 2013, the 60-day intervention period expired. At the expiration of the intervention period, no requests to intervene had been received by the Commissioner.

DISCUSSION

BCBSM uses its Large Group Rating System to price benefits for groups with more than 50 subscribers. As of November 30, 2012, BCBSM had average monthly contracts of 251,719 in this category. The Large Group Rating System (LGRS) formulas include development of projected premium income and settlements of prior year contracts, including calculations of rate

stabilization reserves, investment income, and cash refunds. The formulas include adjustments or provisions for IBNR, trend, credibility, pooling of large claims, risk based capital, and administrative expense factors

BCBSM's proposed modifications to its current LGRS (formerly called ERS) are described in Section 1 of the filing and shown algebraically in Section 2 of the filing. A brief recap of some of the current factors will be discussed, followed by a recommendation on each proposed modification.

Large Group Definition

Currently, this market segment includes groups with more than 50 subscribers. They are rated as one pool.

Due to changes in PPACA definitions of both Small and Large Groups which take place in 2014, during which this particular filing will be in effect, BCBSM has proposed separating this market segment into three (3) rating pools. This segmentation will ease the transition for these group sizes between small and large group due to changing PPACA group size definitions. The proposed rating pools are:

- 1) 2-50 enrolled contracts (some will be large group in 2014, but small group in 2016) This pool will be addressed further below
- 2) 51-99 enrolled contracts (some will be small group in 2016)
- 3) 100+ enrolled contracts

Staff recommends this proposed change in methodology be approved.

Base Rate Structure Change

Currently, BCBSM utilizes a single base rate table for both its large and small group market segments.

In addition to separating the large group market segment into three rating pools, BCBSM has also proposed:

- separating its base rate tables between small and large group customers
- varying base rates between pre-65 active and pre-65 retirees
- revising their methodology from a three- to four-tier structure.

PPACA requires different rate structure and benefit options in the small and large group markets beginning in 2014. Again, this occurs while this filing will be in effect. By utilizing distinct base rate tables, BCBSM will improve its rating and reporting accuracy.

In the pre-age 65 market, experience documents the lower cost of active employees compared to early retirees. BCBSM proposes varying rates to reflect that experience while remaining revenue neutral in the aggregate for the pre-65 segment.

BCBSM currently utilizes a three-tier rating structure of single, two-person and family contracts. The proposed change is to a four-tier rating structure of employee, employee plus spouse, employee plus child(ren), and family. This, too, will be revenue neutral and reflect the lower costs of children.

Staff recommends these proposed changes in base rate structure and rate tiers be approved.

Rating Groups with 50 or Less Enrolled Contracts

This segment of the LGRS represents employer groups that, due to changing definitions of small and large groups, will be moving from one BCBSM rating methodology to another. Employer groups with more than 50 employees but 50 or less enrolled contracts are now rated under the ARS (small group) methodology.

In 2014, this segment of BCBSM's business will be considered large groups under PPACA, and will be subject to the LGRS. However, due to their size, their experience will not be credible.

As an aside, in 2016, when the PPACA definition changes again, these groups will once again be considered small groups.

Rating employer groups of this size as a separate pool, as previously described under the Large Group Definition section above, will help to avoid rating disruption. BCBSM further proposes utilizing the applicable base rate table (small or large), as employer groups in this pool transition from one rating methodology to another.

Additionally, as will be discussed in reference to all three (3) rating pools, BCBSM has proposed caps/floors to minimize the impact of the various rating changes on employer groups of this size.

Lastly, for employer groups with 50 or less enrolled contracts, BCBSM proposes a new methodology, to be discussed in a later section, which deals with new taxes and fees prescribed by state or federal legislation or regulation.

Formula Changes for Large Groups with More Than 50 Enrolled Contracts

The LGRS formula utilizes a credibility formula, large claim pooling, trends based on group size, and the option for a two-year rate guarantee. Additionally, the LGRS allows BCBSM to make certain exceptions without prior approval as outlined specifically in previous ERS Orders. In this filing, BCBSM has proposed several modifications to the current methodology.

Credibility Formula

Currently, the credibility formula uses a one year experience period as the credible portion of the projected claims for a group, an updating ratio, and the experience of the pool for the non-credible portion of the projected claims. This formula can result in rate volatility due to the "assumption" the pool's average experience is stable and the group's experience is predictive of future experience. Additionally, the third-year renewal may produce rate shock when, at initial enrollment, there is no experience available or it's not credible. This then results in improper experience weighting at the second- and third-year renewals.

BCBSM proposes a new credibility formula which includes a manual rate to replace the updating ratio. This manual rate will be derived from the large group pool and adjusted for the specific employer group's demographics, i.e. age, area, industry, group size and participation. The manual rate component calculation is shown on page 9 of the filing. A portion of this calculation includes the All Group Ratio. This Ratio, defined on page 31 of the filing, will be

updated quarterly and included in BCBSM's quarterly filings. The proposed formula will result in a second renewal based on actual first-year experience. BCBSM states this proposed change will be revenue neutral while providing rate stabilization from year to year.

Large Claims Pooling

Currently, BCBSM pools only large medical claims.

BCBSM proposes including large drug claims with the large (medical) claims pooling at the group's \$75,000 pooling limit. One large drug claim can cause a very large increase in the drug rate component. By pooling large drug claims with other large claims, rate volatility can be lowered.

Additionally, BCBSM proposes adding an age factor to the demographic adjustment used in the pooling fee. BCBSM has stated age is fundamentally linked to the incidence of large claims. These two changes to large claims pooling will be revenue neutral.

Vary Claims Trend by Group Size

Currently, the LGRS utilizes the same claims trend for all 100+ insured groups. BCBSM proposes varying the claims trend by group size for those groups with 100+ contracts. The group sizes will be 100-299, 300-999, and 1000+. These trends will be included in the monthly LGRS factor filings.

Two-year Rate Increase Guarantee

Currently, BCBSM is allowed to offer a two-year rate increase guarantee for Formula III groups meeting predefined criteria. However, such a guarantee has not yet been implemented.

The two-year rate guarantee is calculated by averaging the expected rate increases for a two-year period. This is an option to employer groups and offered only to groups whose characteristics (demographics and benefits) remain essentially the same. This option provides rate stabilization to groups.

Additional Rating Flexibility

Currently, the December 7, 2000 Order defines specific exceptions to BCBSM's LGRS that may be made without prior approval.

Beyond the currently approved exceptions, BCBSM has proposed several new exceptions in this LGRS filing to afford flexibility.

1. **Contract Tiers** – In addition to the previously mentioned proposed change to a standard four contract tier rating structure, BCBSM proposes the option of some employer groups the choice of two-, three-, or five-tier structure instead of the four-tier structure. This would be offered to groups wishing to align their rating tiers with employer-defined contribution schedules, union contract tiering or simply to accommodate various family schemes of the employer group. Such re-tiering would be done in a revenue neutral manner.
2. **Rate Stabilization Reserve (RSR) Recoupment** – For the approximate 200 employer groups rated under retrospective rating formulas, BCBSM proposes allowing the option of removing the RSR calculation for dental and/or vision. RSR is used to protect a group from the difference between revenue and expenses at the

end of a rating year. Because dental and vision typically are predictable lines of business, the need for potential recoupment is relatively small.

3. **Administrative Expense Modifications Due to Employer Specific Commission Structures** – BCBSM proposes allowing employer groups to negotiate group specific commission. This would be negotiated directly between the group and its agent and would replace the standard commission expense from the administrative expense charge. BCBSM states the impact on the overall rate would be only the change in the commission; therefore, there would be no impact on the pool's performance or on any other group. BCBSM would monitor these negotiated commission rates and their impact on the MLR.
4. **Pooling Limit** – BCBSM proposes allowing employer groups with more than 1,000 contracts (as opposed to the current applied 5,000 contracts) to opt out of the specific stop-loss pooling or raise the stop-loss limit. This option will have no impact on the pool, however, BCBSM includes all large groups as well as ASC groups with stop-loss coverage in the derivation of the stop-loss pooling charge to ensure the use of a credible pool in the pooling factor development.
5. **Ancillary Product Rating for Coexistent BCBSM/BCN Groups** – Currently, employer groups offering both BCBSM and BCN medical coverage, provide dental and/or vision through BCBSM. Since BCBSM utilizes experience rating and BCN is community rated, the BCBSM rate is better. Therefore, BCBSM proposes combining membership and claims experience and utilizing BCBSM experience-rating for all dental and/or vision even if the medical is written through BCN.
6. **Caps and Floors for All Large Group Rating Segments** – Due to the proposed changes to the LGRS as well as the possibility of additional changes required with the implementation of PPACA, BCBSM is proposing caps and floors be applied to all groups. These caps/floors will be calculated by line of business (i.e. BC, BS, drug, dental, & vision). Experience for each line of business as well as trend projections will be calculated prior to determining caps/floors. If the actual calculated rate increase/(decrease) falls outside of the cap/floor, the rate change will be held at the appropriate level. At this time, BCBSM has not yet determined its caps/floors, but these will be filed with the monthly factor filings.
7. **Future Modifications** – In addition to the aforementioned exceptions, BCBSM has proposed the ability to submit proposed modifications to this filing should it be deemed necessary in the future. Any proposed modifications would be submitted along with supporting documentation and be subject to prior approval. Additionally, BCBSM requests that future modifications be subject to a 30-day review period with the 30-day period beginning once OFIR determines it has the information necessary to evaluate the request.

ORDER

Based on the foregoing, it is ORDERED:

1. BCBSM may segment its Large Group market segment into the proposed three (3) rating pools in order to align with PPACA definitions of large group in 2014 and 2016, during which this filing will be in effect.
2. BCBSM may establish two distinct base rate tables - one for large groups and one for small groups; vary its base rates depending on pre-65 active and pre-65 retiree status;

and revise its tiering structure from a three- to four-tier structure. Each of these changes will improve rating accuracy as well meet requirements of PPACA.

3. In 2014, when groups with 50 employees (but less than 50 enrolled contracts) are considered large groups under PPACA, BCBSM may rate these employer groups as a separate pool utilizing the applicable base rate table, and apply the propose caps/floors to minimize the impact of the rating changes to groups of this size.
4. With regards to employer groups of more than 50 enrolled contracts:
 - a. The credibility formula, as proposed, is approved.
 - b. The large claims pooling, as proposed, of both medical and drug, along with an age factor adjustment, is approved.
 - c. The proposed claims trend by group size, as proposed, is approved.
 - d. The two-year rate increase guarantee, as previously approved, remains approved.
 - e. The proposed rating flexibility situations, as proposed, including contract tiers, RSR recoupment, administrative expense modifications due to employer specific commission structures, pooling limit, ancillary product rating for coexistent BCBSM/BCN groups, and caps/floors for all large group rating segments, are approved.
5. BCBSM may submit proposed modifications with appropriate supporting documentation for consideration by OFIR with an anticipated 30-day review period. Any review period beyond 30 days will be mutually agreed upon by OFIR and BCBSM.
6. Beginning with contracts effective on or after January 1, 2016, BCBSM must remove all contracts with 51-100 eligible employees from the Large Group Rating System and combine them with BCBSM's remaining small group experience in accordance with the single risk pool requirements under Section 1312(c) of PPACA.

Jurisdiction over the matters contained herein is specifically retained by the Commissioner along with the authority to enter such further order or orders as he shall deem just, necessary and appropriate.



Rhonda Fossitt, Deputy Commissioner
Office of Financial & Insurance Regulation
Health Plans Section
Insurance Rates & Forms Division